

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Curt Hébert, Jr., Chairman;
William L. Massey, and Linda Breathitt.

AES Southland, Inc. Docket No. IN01-3-000
Williams Energy Marketing & Trading Company

SHOW CAUSE ORDER

(Issued March 14, 2001)

The California Independent System Operator (ISO) referred to the Commission circumstances relating to the operation by Williams Energy Market & Trading Company (Williams) and AES Southland, Inc., including its subsidiaries AES Alamitos, L.L.C. and AES Huntington Beach, L.L.C. (collectively, AES) of certain reliability must-run (RMR) generation units located in Orange County, California during April and May 2000. A preliminary, non-public investigation conducted by the Commission staff has raised serious questions about whether Williams and AES, by failing to provide power from certain designated RMR units, violated section 205 of the Federal Power Act and agreements on file with the Commission. In this order, the Commission directs Williams and AES to show cause why they should not be found to have engaged in violations and directed to make refunds and have certain conditions placed on Williams' market-based sales authority for a limited period.

I. REGULATORY AND CONTRACTUAL BACKGROUND

Williams is a wholesale seller of electric energy in California with authority to charge market-based rates. Williams has filed contracts with the Commission in connection with its authority to make RMR sales to the ISO. Williams makes RMR sales from specified generation units, Alamitos 4 and Huntington Beach 2, which are owned and operated by AES. AES has filed a contract it has with Williams, referred to herein as the Tolling Agreement, that sets forth the terms pursuant to which AES will operate Alamitos 4 and Huntington Beach 2, among other units. From April 25 through May 11, 2000, Williams and AES agreed that the units designated as RMR units would not be available for service when dispatched by the ISO. This unavailability caused the ISO to dispatch other units, that are also owned by AES and whose electric energy is sold by Williams, at prices many times higher than the applicable RMR contract price or the then-prevailing market price.

A. RMR Units

In December 1996, the Commission directed the ISO to designate RMR units in

California.¹ An RMR unit is a generating facility that the ISO can call upon when necessary to provide energy and ancillary service essential to the reliability of the California transmission network.² The ISO pays an RMR owner or agent a fixed payment to compensate for the RMR unit's availability and a second, variable payment to compensate for the RMR unit's output at cost-based rates if the unit is not otherwise participating in the market.³ The ISO designated Alamitos 4 and Huntington Beach 2 as RMR units, among others, and the Commission approved the ISO's pro forma RMR agreement.⁴

B. Locational Market Power

In 1998, Southern California Edison Company (Edison) sold its Alamitos and Huntington Beach plants to AES.⁵ These plants have locational market power with respect to the provision of RMR services because no other generation units can provide these services.⁶ The Commission has recognized

¹Pacific Gas and Electric Company, 77 FERC ¶ 61,265 at 62,092 (1996).

²See, e.g., Duke Energy Oakland LLC, 85 FERC ¶ 61,047 at 61,141- 42 n.1 (1998). Stated alternatively, it is a generating unit, the absence of which "could compromise reliability in different ways, including reduced voltage support on the system . . . " California ISO, "2000 Reliability Must-Run Technical Study of the ISO-Controlled Grid," page 3 (August 1999).

³See, e.g., Southern Energy Delta, L.L.C., 93 FERC ¶ 61,265 at 61,842 (2000).

⁴Pacific Gas and Electric Company, 81 FERC ¶ 61,122 at 61,557 (1997).

⁵The Commission noted this in AES Huntington Beach, L.L.C., 83 FERC ¶ 61,100 (1998).

⁶In a proceeding before the Commission following Edison's filing of a proposed RMR agreement, a witness for Edison explained the need for RMR services and the market power that the providers of such services control, as follows:

Traditionally, utilities developed their systems on a largely vertically integrated basis, substituting between generation and transmission investments where it was economical to do so. As a result, some generating facilities currently function as substitutes for transmission. These generators must be operated during certain critical times to assure that, if some other key generation or transmission facility fails, there will be adequate power delivered locally to meet customer demand and the electric system will be protected from voltage collapse, instability, or thermal overloading of transmission. Under the new

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that a firm, such as Williams, has locational market power if it controls the only generators that can provide a service that the ISO requires,⁷ and the ISO has reached the same conclusion.⁸

C. The Tolling Agreement

Williams and AES executed a contract, known as the Tolling Agreement, that became effective in May 1998.⁹ Under this agreement, Williams exclusively markets the output from the Alamos and Huntington Beach plants, which AES owns, operates and maintains.¹⁰ The

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market structure, during these critical hours, owners of these specially situated generation facilities could charge unreasonably high prices if they expect the ISO will require them to operate to assure local reliability. Therefore, the public policy task is to ensure that these generation facilities are available to operate when needed for local reliability while controlling their potential to exercise market power. Divestiture cannot solve this problem because these "must-run" facilities will have potential market power regardless of who owns them.

Prepared Direct Testimony of John L. Jurewitz, Docket No. ER98-441-000, filed June 15, 1998.

⁷California Independent System Operator Corporation, 90 FERC ¶ 61,006 at 61,011 (2000) ("In this situation, there is no effective competition to relieve the constraint and no market discipline on the bid price by a generator that has the ability to reduce its schedule.").

⁸California Independent System Operator, Report of Control Activities, November 30, 1999, page 19 ("This locational energy need provides the RMR designated unit an opportunity to exercise market power.").

⁹See the Capacity Sale and Tolling Agreement filed in Docket Nos. ER98-2184-004, ER98-2185-004 and ER98-2186-004.

¹⁰ The Commission summarized the Tolling Agreement briefly in AES Huntington Beach, L.L.C., 87 FERC ¶ 61,221 at 61,876 (1999).

Commission has stated that the Tolling Agreement is a contract providing for the sale for resale of electricity in interstate commerce.¹¹

The Alamitos plant consists of seven operational units and the Huntington Beach plant consists of two operational steam units.¹² Williams has the right under the Tolling Agreement to dispatch any unit in the plants at any time as long as AES has first notified Williams that the unit Williams wishes to dispatch is available.¹³ AES, as the owner of the plants, is required to operate and maintain the Alamitos and Huntington Beach units in accordance with Accepted Electrical Practices.¹⁴ The Tolling Agreement states that AES shall bear all costs of operation and maintenance.¹⁵ It contains incentives for AES

¹¹AES Huntington Beach, L.L.C., 87 FERC ¶ 61,221 at 61,877 (1999). The Tolling Agreement was filed with the Commission and, in effect, serves as a rate schedule because it sets forth the rates, terms and conditions under which AES' sales of power are made.

¹²Tolling Agreement, Schedule 4.2 at page 4.2-1. Operations at the third plant subject to the Tolling Agreement, Redondo Beach, are not involved in this investigation.

¹³Tolling Agreement, Article 8, page 21.

¹⁴Tolling Agreement at Article 9.1, page 26. The agreement defines Accepted Electrical Practices to mean

Those practices, methods and acts engaged in or approved by a significant portion of the electric utility industry during the relevant time period, or any of the practices, methods and acts which, in exercise of reasonable judgment in light of the facts known at the time a decision is made, that could have been expected to accomplish a desired result at reasonable cost consistent with good business practices, reliability, safety and expedition. Accepted Electrical Practices are not intended to be limited to the optimum practices, methods or acts to the exclusion of others, but rather to those practices, methods and acts generally accepted or approved by a significant portion of the electric utility industry in the relevant region, during the relevant time period, as described in the immediately preceding sentence.

Article 1.1, page 1.

¹⁵ Tolling Agreement at Article 9.1, page 26.

to make the plants available for Williams to dispatch.¹⁶ It also contemplates that Williams and AES will coordinate the timing of outages.¹⁷

D. RMR Agreements

Williams and the ISO have executed RMR agreements with respect to the Alamitos and Huntington Beach plants and filed them as rate schedules with the Commission.¹⁸ Pursuant to these agreements, the ISO may issue a dispatch notice "solely for purposes of meeting local reliability needs or managing intra-zonal congestion."¹⁹ The ISO may dispatch a non-RMR unit if the designated RMR unit is not available.²⁰ Pursuant to its RMR agreement with the ISO, Williams is paid the greater of its contract price or marginal cost for operating RMR units.²¹

The Tolling Agreement states that AES shall operate the plants "in a manner not

¹⁶Tolling Agreement at Article 4, pages 14-16. The availability provisions of the Tolling Agreement state that Alamitos Unit 4 and Huntington Beach Unit 2 must be available 86 percent of the 12-month period ending May 31 of each year. This requirement is termed the "guaranteed availability" of the units. See Tolling Agreement, Schedule 4.2.

¹⁷Tolling Agreement at Schedule 8.2, page 8.2-2. Schedule 8.2 states in pertinent part that Williams "will provide the AES Subsidiaries [Williams'] preferred outage dates within 24 hours of the receipt [of the] outage request. If the [Williams] dates and the AES Subsidiaries dates do not coincide, the parties will work in good faith to determine the outage date and if unable to agree, the outage schedule will be determined pursuant to Article XII." Article XII relates to dispute resolution using arbitration. Id. at page 31.

¹⁸See, e.g., Must-Run Service Agreement between Williams and the ISO filed April 13, 1999 in Docket Nos. ER98-441-000 and ER98-2550-000 (for the Alamitos and Huntington Beach plants). These agreements, filed with the Commission, as supplemented, set forth the conditions under which Williams made market-based rate sales of services from RMR units.

¹⁹E.g., id. at Article 4.1(b), Alamitos RMR Agreement, p. 24. This description includes voltage support. E.g., id., Schedule E, p. 35.

²⁰See California Independent System Operator Corporation, 90 FERC ¶ 61,006 at 61,010-11 (2000).

²¹E.g., Article 8, Alamitos RMR Agreement, pp. 69, et seq.

inconsistent" with the RMR agreement.²² The RMR agreements, in turn, recite that Williams "shall cause the Unit to be fueled, operated and maintained, in accordance with applicable law and Good Industry Practice and with due regard for the reliability purpose of this Agreement."²³ Each RMR agreement defines Good Industry Practice in broad terms to include practices generally engaged in or which were reasonable under the circumstances.²⁴

E. The ISO Tariff

The ISO's tariff contains Market Monitoring Information Protocols (MMIP) that define "abuse of RMR unit status."²⁵ Abuse includes operating RMR units to the detriment of competition and efficiency.²⁶ The MMIP also addresses "gaming," which it defines as "taking unfair

²²Tolling Agreement at Article 9.1, page 26.

²³E.g., Alamitos RMR Agreement, Article 7.1, p. 51.

²⁴Specifically, each agreement states that Good Industry Practice

Means any of the practices, methods, and acts engaged in or approved by a significant portion of the electric power industry during the relevant time period, or any of the practices, methods, and acts which, in the exercise of reasonable judgment in the light of the facts known at the time the decision was made, could have been expected to accomplish the desired result at a reasonable cost consistent with good business practices, reliability, safety and expedition. Good Industry Practice does not require use of the optimum practice, method, or act, but only requires use of practices, methods, or acts generally accepted in the region covered by the Western System Coordinating Council.

Alamitos RMR Agreement, Article 1, pp. 7-8. This definition is almost identical to the definition of "Accepted Electrical Practices " in the Tolling Agreement.

²⁵The MMIP is a "workplan" that sets forth rules under which the ISO monitors markets. ISO MMIP § 1.1; Original Sheet No. 713.

²⁶ISO MMIP § 2.1.2, Original Sheet No. 716, defines "Abuse of [RMR] Unit Status" as follows:

Where Generating Units are determined by the ISO to be Reliability Must-Run Units, circumstances that indicate that such Generating Units

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advantage" of conditions such as "facility outages" which render the system vulnerable to price manipulation.²⁷

In early 2000, the Commission ruled that the bid price, and not the RMR contract price, would apply where an RMR unit is unavailable for service and the ISO must dispatch a non-RMR unit to provide required service.²⁸ The ISO passes through costs for services, whether or not provided by RMR units, to the utility transmitting the power, which in turns passes through the costs to consumers.²⁹

F. Williams' Market-Based Rate Authority

²⁶(...continued)

are being operated in a manner that will adversely affect the competitive nature and efficient workings of the ISO Markets.

²⁷ISO MMIP § 2.1.3, Original Sheet No. 716, defines "Gaming" as

taking unfair advantage of the rule and procedures set forth in the PX or ISO Tariffs, Protocols or Activity Rules . . . to the detriment of the efficiency of, and of consumers in, the ISO Markets. 'Gaming' may also include taking undue advantage of other conditions that may affect the availability of transmission and generation capacity, such as loop flow, facility outages, level of hydropower output or seasonal limits on energy imports from out-of-state, or actions or behaviors that may otherwise render the system and the ISO Markets vulnerable to price manipulation to the detriment of their efficiency.

²⁸California Independent System Operator, 90 FERC ¶ 61,006 (2000), issued January 7, 2000, on rehearing, 91 FERC ¶ 61,026 (2000), issued April 12, 2000.

²⁹See, e.g., Southern California Edison Company, 93 FERC ¶ 61,334 (2000).

Williams operates under market-based rate authority from the Commission.³⁰ In 1998, the Commission approved jurisdictional rate schedules in the form of market-based rate authority for the AES subsidiaries that own the Alamos and Huntington Beach plants.³¹ The Commission stated that it "allows power sales at market-based rates if the seller and its affiliates do not have, or have adequately mitigated, market power in generation and transmission and cannot erect other barriers to entry."³² Later that year, the Commission granted AES' request to assign the rate schedules to Williams.³³ The Commission stated that "[u]pon assignment, [Williams] will assume the responsibility to fulfill the California ISO's dispatch notices issued to these RMR units."³⁴

II. FACTUAL BACKGROUND

The Alamos plant is comprised of six steam units and one combustion turbine peaking unit. Units 1 and 2 have a generating capacity of 175 MW each, Units 3 and 4 have a generating capacity of 320 MW each, and Units 5 and 6 have a generating capacity of 480 MW each. The Huntington Beach plant has four steam units. Units 1 and 2 have a generating capacity of 215 MW each. Units 3 and 4 were retired in 1996.

³⁰Unpublished letter order issued March 10, 1995 in Docket No. ER95-305-000. The market-based rate authority was transferred to a Williams corporate entity in an unpublished letter order issued June 7, 1995 in Docket No. ER95-305-001. A name change to Williams Energy Services Company (WESCO) was accepted by unpublished letter order issued January 16, 1996, in Docket No. ER95-305-004. See AES Alamos, L.L.C., 84 FERC ¶ 62,130 (1998). WESCO subsequently became Williams Energy Marketing & Trading Company. See Letter filed February 3, 1999 in Docket No. ER99-1722-000. The Commission granted Williams' request for a continuation of its authority to sell capacity and energy for resale at market-based rates, and permitted Williams to provide specified ancillary services at market-based rates. Williams Energy Services Company, 84 FERC ¶ 61,072 (1998). These market-based rates for ancillary services are subject to a cap on bids imposed by the ISO. AES Redondo Beach, L.L.C., 84 FERC ¶ 61,046 (1998) (permitting imposition of cap on a provisional basis); 85 FERC ¶ 61,123 at 61,462-64 (1998) (continuing price cap authority).

³¹AES Huntington Beach, L.L.C., 83 FERC ¶ 61,100 (1998). See also, AES Redondo Beach, L.L.C., 83 FERC ¶ 61,358 (1998); 87 FERC ¶ 61,221 (Order Denying Rehearing) (1999).

³²83 FERC at 61,481.

³³AES Alamos, L.L.C., 84 FERC ¶ 62,130 (1998).

³⁴Id. at 64,204.

During the April to May 2000 period, the ISO sought to dispatch both Alamitos 4 and Huntington Beach 2 as RMR units to provide voltage support. From April 25 through May 5, 2000, the ISO sought to dispatch Alamitos 4, but it was unavailable. Consequently, the ISO was forced to dispatch a non-RMR unit, Alamitos 3, to provide replacement service for Alamitos 4. Similarly, beginning May 6, 2000, the ISO sought to dispatch Huntington Beach 2 but it was unavailable. Consequently, the ISO was forced to dispatch the only non-RMR unit available, Alamitos 5, to replace Huntington Beach 2. The Timeline of Events in Attachment 1 indicates the status of the relevant units during the period in question.³⁵ Additional information with respect to the reasons that Williams and AES provided for the outages is set forth in the non-public Appendix.

If the RMR units had not experienced outages from April 25 through May 11, 2000, Williams would have received either (1) the market revenues only from the respective units, which would have resulted in no payments for RMR output from the ISO to Williams, or (2) Williams' variable cost for operating the RMR units less the market revenues from the respective units' output.³⁶ Accordingly, Williams had a financial incentive to prolong any outages of Alamitos 4 and Huntington Beach 2 in April and May 2000.

Williams received more revenues as a result of the respective outages at Alamitos 4 and Huntington Beach 2 because it received the bid price for service provided by the replacement, non-RMR units. The bid price for the non-RMR units was at or near the ISO's then-effective bid cap of \$750 per Mwh. Williams received payments from the ISO of more than \$11.3 million. While Williams' bid price was at or near \$750 per MWh, the estimated average variable operating cost of the non-RMR units during the period in question was approximately \$63 per megawatt hour. Williams received total estimated revenues less expenses of \$10,282,549. Accumulated interest at the Commission's published interest rate from September 1, 2000 through March 31, 2001 is \$575,226. The total refund amount would be \$10,857,775. Details regarding the total estimated revenue to Williams are contained in Table 1 to the non-public Appendix to this order.

III. SHOW CAUSE

The ISO referred this matter to the Commission,³⁷ whereupon the Commission

³⁵The ISO is the source for Attachment 1.

³⁶See RMR Agreement, Article 8, page 70.

³⁷The ISO referred this matter pursuant to section 1b.8 of the Commission's regulations, 18 C.F.R. § 1b.8 (2000). Pursuant to section 1b.8(c), the Commission determines that the disclosure of the ISO as the entity that referred this matter will aid the investigation.

commenced a preliminary, non-public investigation.³⁸ With respect to Alamos 4, information obtained in the investigation indicates that AES and Williams refused to make this unit available, for all or part of the period April 25 through May 5, 2000, for reasons that were not directly related to the necessary and timely maintenance of this unit. The effect of this apparent refusal was to require the ISO to pay the bid price that Williams submitted for non-RMR units at the Alamos plant that the ISO was forced to dispatch, rather than the payment that Williams would have received had Alamos 4 been available. With respect to Huntington Beach 2, the information indicates that AES and Williams refused to make this unit available from May 6 through May 11, 2000, for reasons that were not directly related to the necessary and timely maintenance of the unit. Further, the information indicates that the condition under which AES and Williams made Huntington Beach unavailable resulted from their apparent failure to maintain the Huntington Beach plant in accordance with the applicable RMR agreements and the Tolling Agreement.

The information in this order and in the non-public Appendix raises serious questions about whether AES and Williams violated applicable RMR contracts and tariffs on file with the Commission pursuant to section 205 of the Federal Power Act when Alamos 4 and Huntington Beach 2 were unavailable to be dispatched by the ISO. It also raises questions whether Williams acted inconsistently with its market-based rate authority and the Market Monitoring Information Protocols of the ISO's tariff with respect to the unavailability of the RMR units during the period at issue. Further, the information raises questions whether AES violated the Tolling Agreement, on file with the Commission pursuant to section 205 of the Federal Power Act.

Williams had an incentive to make the Alamos 4 and Huntington Beach 2 RMR units unavailable because when the ISO had to dispatch substitute, non-RMR, units Williams received more revenues. The information obtained in the non-public investigation, and discussed in the non-public Appendix to this order, suggests that Williams took action to extend the outage at Alamos and to make Huntington Beach 2 unavailable for pretextual reasons. The information also suggests that AES declared outages at these plants and maintained Huntington Beach 2 in a manner that was inconsistent with good utility practice.

The remedies for these potential violations would be, first, a refund by Williams and/or AES to the ISO of the revenues Williams received in excess of the amount it would have collected from the ISO had Williams and AES not engaged in the practices discussed in this order and the non-public Appendix. Such a refund would place Williams in the same position it would be in had Williams and AES permitted the ISO to dispatch the RMR units. The second remedy would be a condition on Williams' market-based rate authority. For a one-year period, if an RMR unit is not available when dispatched by the ISO, a non-RMR unit

³⁸Commission staff conducted this investigation pursuant to Part 1b of its regulations, 18 C.F.R. Part 1b (2000).

dispatched in its place would only receive payment according to the terms set forth in the applicable RMR contract. In other words, Williams would not receive the bid price for operation of the substitute, non-RMR unit. This remedy would place the risk on Williams for the failure of an RMR unit.

The Commission directs Williams and AES to show cause, within 20 days of the date of this order, why the Commission should not find that Williams and AES undertook the actions and committed the violations discussed above and in the ordering paragraphs below, and why the Commission should not impose the remedies discussed above. Further, to ensure that all relevant information can be gathered, the Commission is instituting a formal, non-public investigation with respect to the operation, maintenance and sales of power from the Alamitos and Huntington Beach plants in 2000 and 2001. Based on the responses and any other information that comes to the attention of the Commission in this matter, the Commission may issue further orders, as appropriate.

Information contained in the non-public Appendix indicates that Williams and AES may have acted together to exercise locational market power with respect to Alamitos 4 and Huntington Beach 2. The non-public Appendix also discloses additional information with respect to these units. Part or all of this information may be subject to requests for confidential treatment by Williams and AES. On the date of this order, the Commission will provide copies of the non-public Appendix to Williams and AES. Pursuant to section 1b.20 of the Commission's regulations, 18 C.F.R. § 1b.20 (2000), the Commission will make the non-public Appendix public five days after the date of this order, unless Williams or AES provides a justification to the Commission for continued confidentiality.

The Commission orders:

(A) Williams Energy Marketing & Trading Company is directed, within 20 days of the date of this order, to show cause why it should not be found to have violated section 205 of the Federal Power Act, the contracts, agreements and tariffs discussed above and why it did not act inconsistently with its market-based rate authority with respect to the unavailability of the Alamitos 4 and Huntington Beach 2 as described in this order.

(B) AES Southland, Inc., AES Alamitos, L.L.C. and AES Huntington Beach, L.L.C. are directed, within 20 days of the date of this order, to show cause why they should not be found to have violated section 205 of the Federal Power Act and the Tolling Agreement by shutting down the RMR units as described in this order.

(C) Williams Energy Marketing & Trading Company and AES Southland, Inc., including its subsidiaries, are directed, within 20 days of the date of this order, to show cause why either or both of them should not be directed to refund to the ISO the revenues Williams received in excess of the amount

it would have collected from the ISO had Williams Energy Marketing & Trading Company and AES Southland, Inc. not engaged in the practices described in this order.

(D) Williams Energy Marketing & Trading Company is directed, within 20 days of the date of this order, to show cause why the Commission should not direct it, for a period of one year, to provide to the ISO services from one or more non-RMR units as a substitute for an RMR unit that is not available under the rate terms that would apply if the designated RMR unit had been available.

(E) Pursuant to sections 307(b) and 309 of the Federal Power Act, the General Counsel and persons designated by him are directed to institute a formal, non-public investigation of any and all violations arising out of the conduct of Williams Energy Marketing & Trading Company and AES Southland, Inc., including their parents, subsidiary companies and affiliates, as relevant, with respect to the operation, maintenance and sales of power from the Alamitos and Huntington Beach plants in 2000 and 2001, with full subpoena power, and to report the results of such investigation to the Commission.

(F) Pursuant to section 1b.20 of the Commission's regulations, 18 C.F.R. § 1b.20, the Commission will make the non-public Appendix public five days after the date of this order, unless Williams Energy Marketing and Trading Company or AES Southland, Inc., including its subsidiaries, provides a justification for continued confidentiality.

By the Commission.

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David P. Boergers,
Secretary.

ATTACHMENT NOT ON DISKETTE